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SUBJECT: "FOLHA" COMMENTARY SAVAGES GOB ENERGY MODEL

1. The bill to establish the GoB's would-be new energy-model has been passed by the Chamber of Deputies and is now in the Senate committee-stage (Septel.) Over most of the model's key detail there continues to hang a heavy fog of general uncertainty. Increasingly, though, private-sector and independent commentators are tending to pessimistic judgments with regard to the GoB's designs. A February 1, 2004 column in top leftist daily 'Folha de Sao Paulo' was representative of this growing school of thought. Following is Embassy's unofficial translation of the column.

2. (Begin Text of Unofficial Embassy Translation)

HEADLINE: The Pinocchio Energy Syndrome

Some statements and events that occurred in 2003 and the beginning of 2004 show that (Brazil's) energy-sector authorities have come down with the Pinocchio syndrome. As everyone knows, Pinocchio has a personality disorder that prevents him from telling the truth. With great innocence and charm, Pinocchio doesn't have the courage to stand up for his ideas and, consequently, loses the confidence of those around him.

The current energy team, without the charm and less innocent than Pinocchio, try to fool the market and even society with talk that they are making changes that will assure the necessary investments to regain sustainable growth.

In the electricity sector, at the beginning of 2003 the MME (Ministry of Mines and Energy) team guaranteed that the model proposed during the presidential campaign had been discarded and that, accordingly, market mechanisms and opinions of the agents would be considered in the elaboration of the new model.

The first surprise came in July 2003, when the preliminary document was divulged. Right away you could see that the "Lula light" philosophy had not contaminated the MME team. However, faced with criticisms from the market, society and even other areas of the government, the MME continued to say that the final version of the model would take into account all the suggestions presented. This was because one of the principal objectives of the new model would be the attraction of private capital. Much to our surprise, at the end of last year the MME sent two MPs (provisional measures) proposing a centralizing and state model to the President of the Republic. In its essence, the ideas contained in the two MPs are similar to those that circulated (in the PT platform) during the presidential elections.

Another event that forced the government to reconsider some of its positions is the recent energy crisis in the Northeast. It is good to remember that during the presidential campaign, and even after Lula took office, some of the current authorities in the sector proposed breaking contracts both with the emergency thermal-plant operators as well as with the PPT. Even some professors who currently hold office in the government suggested bringing suits against the contracts with the Public Ministry.

In light of these declarations, the start in operations of the emergency thermal plants was delayed to the maximum, obviously with costs to the consumers. However, with the worsening of the crisis, the government "did an about face", and during the second week of January (2004), more than 30 thermals were turned on, at a cost of R\$230 to R\$430 per MWh.

In the petroleum sector there are two stories. The first is the lack of transparency in the policy for gasoline, diesel and GLP prices. Petrobras claimed throughout 2003 that their prices were the same or less than those on the international market. However, when we compare the prices of Petrobras with those of American golf, we verify that the internal prices were always higher than the external ones. This explains, in part, the result presented by Petrobras' supply section. In 2003, this section, responsible for the sale of derivatives, accounted for around 30% in the total

profit of the company, while in 2002 it was only 15%.

The second story is linked to the bidding on petroleum and natural gas blocs. In July last year, on the eve of the auction in these areas, the CNPE (Nacional Council on Energy Policy) published Resolution No. 08. The resolution contains two points that seem to have passed unnoticed by the market. The first took away, in practice, ANP's authority to grant concessions. The second created two concepts emblematic of the current government's interventionism: the concept of the ideal relationship (sic) between reserves and production, and that of the adequate volume (sic) of reserves in the country. In reality, this resolution strengthens the MME and leaves it to be understood that once self-sufficiency is attained, new auctions (concessions) will no longer be necessary.

In the field of regulation, the government passed the year alternating between being for and against autonomy and independence of the agencies. However, at the end of 2003, the government appeared to have opted for building a regulatory standard through which the agencies have their power reduced and their decisions politicized. This became clear with the appointment of a politician with a position against the opening of the petroleum and gas sector to the ANP board of directors, and the dismissal of the president of ANATEL for having disagreed with the Minister of Communications.

No matter how competent the government is in the art of hiding its true intentions, it's not possible to fool everyone all the time.

In this sense, it is a shame that after all the time and work put into achieving macroeconomic stability, the government lets a unique opportunity for attracting private investment for the infrastructure sector get away.

In 2004, the government needs to assume an attitude compatible with our real needs. This means separating the Entrepreneur-state from the Regulator-state; establishing a regulatory and tax model that offers incentives to private investment; and stimulating competition. If not, we will be promoting the break up of our macroeconomic equilibrium.

(End Text of Embassy Translation)

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